FILE COPY

Office - Supreme Court, U. S.
FILED
FEB 1, 1938
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 374.

TICONIC NATIONAL BANK, PEOPLES-TICONIC NATIONAL BANK, AND ARTHUR G. PICHER, as Receiver of Each Said Banks, *Petitioners*,

v.

LOTTIE F. SPRAGUE AND MARGARET DAVIS SPRAGUE, *Respondents*.

REPLY BRIEF FOR PETITIONERS TO RESPONDENTS' BRIEF AND TO BRIEF OF THE RECONSTRUCTION FINANCE CORPORATION AS AMICUS CURIAE.

F. HAROLD DUBORD,
Attorney for Petitioners.

GEORGE P. BURNS,
TREVOR V. ROBERTS,
JAMES LOUIS ROBERTSON,
Attorneys for the Comptroller of the Currency,
Of Counsel.

Press of Byron S. Adams, Washington, D. C.

INDEX.

Subject Index.

	Page
1. Reply to Respondents' Brief	1
2. Reply to Reconstruction Finance Corporation's Brief as Amicus Curiae	3
3. Appendix	14

CASES CITED.

Aldrich v. Chemical National Bank, 176 U. S. 618, 44 L. Ed. 611	4, 8
B. and A. R. R. Co. v. Mercantile Trust and Deposit Co., 82 Md. 535, 34 Atl. 778	2
Bassett v. Fidelity and Deposit Company, 184 Mass. 210; 68 N. E. 205	2
Blake v. Traders National Bank, 145 Mass. 13, 12 N. E. 44	3
Chemical National Bank v. Armstrong, 59 Fed. 372, 375	4
Choate v. Arrington, 116 Mass. 552	3
Earle v. Pennsylvania, 178 U. S. 449	8
First National Bank of Bay City v. Fellows, 244 U. S. 416	2
Greva v. Rainey, 41 Pac. (2d) 328	10, 11
In the Matter of Murray, 6 Paige 204, Paige's Chancery Reports—New York	3
In re Edward Hagan, 10 N. B. R. 383	3
In re Richard, Mary and S. R. Town, 8 N. B. R. 40	3
Merrill v. National Bank of Jacksonville, 173 U. S. 131, 43 L. Ed. 640	8
People v. American Loan and Trust Company, 172 N. Y. 371, 65 N. E. 200	5, 11
Scott v. Armstrong, 146 U. S. 499, 507	4
Sexton v. Dreyfus, 219 U. S. 339, 55 L. Ed. 244	6, 7, 8
White v. Knox, 111 U. S. 784, 787	9

STATUTES AND AUTHORITIES.

Section 11(k) of the Federal Reserve Act, (Section 248(k), Title 12, U. S. C.)	2, 9, 11, 12
Section 52 of the National Bank Act (U. S. R. S. Sec. 5242)	4
R. S. Section 5234, (Title 12, U. S. C. 192)	8
Section 8 of Regulation F of the Federal Reserve Board as amended October 17, 1930	9, App. 14

IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 374.

TICONIC NATIONAL BANK, PEOPLES-TICONIC NATIONAL BANK, AND ARTHUR G. PICHER, as Receiver of Both Said Banks, *Petitioners*,

v.

LOTTIE F. SPRAGUE AND MARGARET DAVIS SPRAGUE, *Respondents.*

On Writ of Certiorari to the Circuit Court of Appeals for the First Circuit.

REPLY BRIEF FOR PETITIONERS TO RESPONDENTS' BRIEF AND TO BRIEF OF THE RECONSTRUCTION FINANCE CORPORATION AS AMICUS CURIAE.

A.

REPLY TO RESPONDENTS' BRIEF.

Respondents have cited several cases in their brief in an attempt to support their position but an examination of those cases reveals either that they have no bearing upon the issues now before the court or that they support petitioners' position.

The first case referred to on Page 2 of respondents' brief as "the Michigan Case", 244 U. S. 416, is properly cited as *First National Bank of Bay City* v. *Fellows,* 244 U. S. 416, decided by this Honorable Court in 1917, and the issue was the constitutionality of the provisions of Section 11(k) of the Federal Reserve Act, (Sec. 248(k), Title 12, U. S. C.). No insolvent national bank was involved and the case has no relation to the question of the stopping of interest as of the date of suspension of an insolvent national bank.

The next case, referred to on Page 3 of respondents' brief, *B. and A. R. R. Co.* v. *Mercantile Trust and Deposit Co.,* 82 Md. 535, can be found in 34 Atl. 778, and involved an insolvent insurance company which prior to insolvency had deposited certain assets with the state treasurer as security for the payment of claims on policies issued by it. The question was whether the holders of those policies were entitled to the proceeds of the securities thus segregated. The court decided that the pledge was a valid one. The only comment about interest made by the court related to one of the claims based upon taxes due. There the court said, at Page 582:

> "We think no interest should be allowed on the claim for taxes or on any of the other claims filed against the insolvent company. While not precisely analogous, the case of Hutchinson v. Liverpool & Lon. & Gl. Ins. Co., 153 Mass. 143, 26 N. E. 439, supports this conclusion. It is not easy, if indeed it be possible, to place upon a consistent basis many of the decisions in which interest has been allowed or disallowed. Perhaps some of the numerous claims might in strictness be entitled to an allowance of interest under ordinary circumstances; but it does not appear that the amounts asserted to be due have been wrongfully withheld by the Casualty Company. The failure to pay, as far as we can see, has been the result of the company's insolvency. A penalty or damages in the way of interest ought not, therefore, to be added to the sums actually due."

The case of *Bassett* v. *Fidelity and Deposit Co.,* 184 Mass. 210, 68 N. E. 205, cited on Page 3 of respondents' brief, in-

volved an action against a solvent surety company and has no bearing upon the instant case. In the case of *Blake* v. *Traders National Bank,* 145 Mass. 13, 12 N. E. 44, likewise cited on Page 3 of respondents' brief, the action was against a solvent national bank and the issues have no relation to the issues in the present case. The next case cited, *Choate* v. *Arrington,* 116 Mass. 552, also involved a suit against solvent sureties and, of course, has no bearing upon the instant case.

The last three cases cited on Page 3 of respondents' brief are properly cited as follows: *In the Matter of Murray,* 6 Paige 204, (Paige's Chancery Reports—New York), *In re Edward Hagan,* 10 N. B. R. 383, and *In re Richard, Mary and S. R. Town,* 8 N. B. R. 40. The first case involved an insolvent insurance company and the last two cases involved bankrupt estates. In all three cases it happened that the assets produced sufficient to pay the claims of all creditors in full with a surplus over and the courts ruled that the creditors were entitled to interest out of that surplus. This, of course, is consistent with petitioners' position as stated on pages 7 and 17 of petitioners' original brief.

It thus appears that respondents have cited no decisions which can be construed as supporting the decisions of the lower courts in the instant case in allowing interest to the respondents for a period subsequent to the date of the suspension of the Peoples-Ticonic National Bank.

B.

REPLY TO BRIEF OF THE RECONSTRUCTION FINANCE CORPORATION AS AMICUS CURIAE.

The Reconstruction Finance Corporation divides its argument into two main points. The *first* is the contention that the lien of the secured contract creditor of a national bank extends to interest to the date of payment and the *second* main point is that a rule to the effect that the appoint-

ment of a receiver for a national bank limits the liens of its secured contract creditors, would be detrimental to national banks.

The Reconstruction Finance Corporation devotes several pages in support of the contention that the National Bank Act does not limit the lien of the secured creditor of a national bank upon the appointment of a receiver therefor. The cases cited, however, do no more than recognize the principle which the petitioners themselves recognize, namely, that all of the assets of the bank pass to the receiver subject to the rights of the creditors with respect thereto. *Chemical National Bank* v. *Armstrong,* 59 Fed. 372, affirmed sub nom; *Aldrich* v. *Chemical National Bank,* 176 U. S. 618; *Scott* v. *Armstrong,* 146 U. S. 499. On page 7 of the brief of the Reconstruction Finance Corporation, the court's attention has been referred to Section 52 of the National Bank Act (U. S. R. S. Sec. 5242) relating to preferential transfers by national banks. This would be pertinent if petitioners were attacking the validity of the contract or the validity of the segregation of assets in the trust department to protect uninvested trust funds. No such attacks are being made by petitioners however. We admit the validity of the contract and we admit the validity of the segregation of securities to protect uninvested trust funds. All we seek to do is to show what rights flow from the valid contract protected by assets validly segregated, when insolvency intervenes.

It is petitioners' position that when insolvency ensues and the forces of government of necessity intervene to take charge of the assets for the purpose of distribution of the proceeds thereof to the various creditors of the insolvent, all of the assets of the insolvent become a trust fund for the benefit of all of the creditors and the rights of the respective creditors whether secured or unsecured, become fixed as of that date. *Chemical National Bank* v. *Armstrong,* 59 Fed. 372, 375; *Scott* v. *Armstrong,* 146 U. S. 499, 507.

If it were possible, in practice as in theory, to convert all of the assets into cash as of the date of insolvency, the secured creditor would receive the benefit of his security and any other pro-rata share in the general assets to which he might be entitled as of that date and no question of interest would be involved. However, the necessary operation of the law for the protection of all creditors and the efficient and orderly liquidation of the assets inevitably entails some delay in the payment of the creditors. This delay is not the fault of the debtor nor the fault of the unsecured creditors but it is the unavoidable result of the insolvency and the necessary intervention of the protective forces of the law. This thought was well expressed in the case of *People* v. *American Loan and Trust Company,* 172 N. Y. 371, 65 N. E. 200, decided by the Court of Appeals of the State of New York in 1902. There, because of the provisions in the charter of the American Loan and Trust Company, which became insolvent, certain of the creditors were preferred. Those creditors were paid in full the principal amount due as of the date of insolvency and then raised the issue as to their right to collect interest. The court said, at Page 379:

> "If the fund in the hands of the court could have been distributed on the same day that the receiver was appointed, no claim of interest could have arisen, for there would have been no delay and no suspension of legal remedies. The delay in distribution, however, was the act of the law itself, and was essential for various purposes, and, among others, to enable the creditors to prove their claims. * * * Interest should not run in favor of one creditor at the expense of another, while the law, acting for all, is administering the assets. If the assets are sufficient to pay all, including interest, it may be paid, for, as against the corporation itself, interest should be allowed before the return of any surplus to the stockholders. As between the creditors themselves, however, no interest should be allowed during the process of administration, and the delay necessarily resulting therefrom, because the assets are equit-

ably their assets, the administration is for their benefit, and the delay is necessary to enable them to take action to present their claims in proper form, as well as to enable the court to put the assets in shape for distribution."

This same equitable principle is clearly enunciated in the case of *Sexton* v. *Dreyfus*, 219 U. S. 339, 55 L. Ed. 244, decided by this Honorable Court in January, 1911. There the creditor of a bankrupt estate having sold his collateral security, sought to apply the proceeds first to interest accrued subsequent to the date of the adjudication, and to file a claim against the bankrupt estate for the unpaid balance. There this Court, while recognizing the strength of the argument in support of the secured creditor's position, said, at Page 343:

"Some further countenance to that course is thought to be found in Sec. 57h, which provides that the value of securities shall be determined by converting them into money 'according to the terms of the agreement,' for it is urged that by construction the right to apply them to interest is as much part of the agreement as if it had been written in. Nevertheless it seems to us that on the whole the considerations on the other side are stronger and must prevail.

"For more than a century and a half the theory of the English bankrupt system has been that everything stops at a certain date. Interest was not computed beyond the date of the commission. Ex parte Bennet, 2 Atk. 527. This rule was applied to mortgages as well as to unsecured debts; Ex parte Wardell, 1787; Ex parte Hercy, 1792, 1 Cooke, Bankrupt Laws, 4th Ed. 181; (1st ed., Appx.) and notwithstanding occasional doubts it has been so applied with the prevailing assent of the English judges ever since * * *. As appears from Cooke, sup., the rule was laid down not because of the words of the statute but as a fundamental principle. We take our bankruptcy system from England, and we naturally assume that the fundamental principles upon which it was administered were adopted by us when we

copied the system, somewhat as the established construction of a law goes with the words where they are copied by another state."

The court further said:

"The rule is not unreasonable when closely considered. It simply fixes the moment when the affairs of the bankrupt are supposed to be wound up. If, as in a well-known illustration of Chief Justice Shaw's *Parks* v. *Boston,* 15 Pick. 198, 208, the whole matter could be settled in a day by a pie-powder court, the secured creditor would be called upon to sell or have his security valued on the spot, would receive a dividend upon that footing, would suffer no injustice, and could not complain. If, under Sec. 57 of the present act, the value of the security should be determined by agreement or arbitration the time for fixing it naturally would be the date of the petition. *At that moment the creditors acquire a right in rem against the assets.* Chemical National Bank v. Armstrong, 59 Fed. Rep. 372, 378, 379; Merrill v. National Bank of Jacksonville, 173 U. S. 131, 140. When there is a delay in selling because of the hope of getting a higher price it is more for the advantage of the secured creditor than of anyone else, as he takes the whole advance and the others only benefit by a percentage, which does not seem a good reason for allowing him to prove for interest by indirection." (Italics ours.)

It is recognized that in bankruptcy under the holding in *Sexton* v. *Dreyfus, supra,* the secured creditor is entitled to apply against interest accrued subsequent to the date of the adjudication, any income accrued and collected on the security for the period subsequent to the date of the adjudication. It was pointed out, however, in petitioners' original brief, Page 12, that this phase of the decision has no application to insolvent national banks because in the case of a bankrupt estate, the secured creditor who wishes to file a claim against the bankrupt estate, must sell or evaluate his security as of the date of the adjudication and reduce his claim by the proceeds or the value of the collateral. Hence,

that creditor virtually becomes the owner of the collateral security from the date of the adjudication and in equity should be entitled to the income, but in the case of an insolvent national bank, the secured creditor is allowed a claim for the full amount due as of the date of suspension without regard to the value of the collateral security. *Merrill* v. *National Bank of Jacksonville,* 173 U. S. 131, 43 L. Ed. 640; *Aldrich* v. *Chemical National Bank,* 176 U. S. 618, 44 L. Ed. 611.

If, in the case of bankrupt estates, the stopping of interest as of the date of the adjudication as prescribed in *Sexton* v. *Dreyfus, supra,* is an essential and reasonable rule adopted in the absence of a specific statutory requirement to that effect, but for the more effective and equitable distribution of the assets of the bankrupt certainly there are equally compelling and cogent arguments in support of the application of that rule to *all* creditors of an insolvent national bank.

The authority of the receiver of a national bank to take possession of and administer all of the assets of the bank is derived from R. S. Sec. 5234, Title 12, U. S. C. 192, which provides in part:

> "Such receiver under the direction of the Comptroller, *shall take possession of the books, records, and assets of every description of such association,* collect all debts, dues, and claims belonging to it, and, upon the order of a court of record of competent jurisdiction, may sell or compound all bad or doubtful debts, and, on a like order, may sell all the real and personal property of such association, on such terms as the court shall direct;" (Italics ours.)

In the case of *Earle* v. *Pennsylvania,* 178 U. S. 449, this Honorable Court in commenting upon the operation of this statute said at pages 454, 455:

> "The scheme of the statute relating to suspended national banks is that from the time of a bank suspension *all of its assets, of whatever kind, as they are at the time of suspension,* pass in the first instance, to the Receiver, the proceeds thereof to be distributed by the

Comptroller among those whose claims are proved to his satisfaction or are adjudicated by some court of competent jurisdiction.'' (Italics ours.)

Petitioners do not contend that the above statutory requirements and the judicial construction thereof deprive the secured creditor of the benefit of his security, but it is believed that as of the date of suspension, the rights of all creditors become fixed, rights in personam are converted into rights in rem and the amounts due the respective claimants as of the date of suspension determine the amounts of the claims whether secured or unsecured against all of the assets of the insolvent bank. *White* v. *Knox,* 111 U. S. 784, 787.

In the instant case the assets on which the lien was fixed in favor of the respondents were assets which had been segregated in the trust department of the bank to secure uninvested trust funds as required by the provisions of 11(k) of the Federal Reserve Act. National Banks conducting fiduciary activities at the time the trust indenture in this case was executed, were subject to the regulations of the Federal Reserve Board and in Section 8 of Regulation F issued by the Federal Reserve Board in 1930, Appendix page 14, it is specifically prescribed that the securities so segregated shall be owned by the bank. A similar provision appears in Section 9 of Regulation F of the Board of Governors of the Federal Reserve System issued in 1936 and cited on page 29 of the appendix to the brief of the Reconstruction Finance Corporation. *In fact, such securities remain in the physical possession of the bank and the receiver takes actual possession thereof upon his appointment. Thus, these securities became part of the trust fund held for the benefit of all the creditors, subject of course, to the lien of the respective trust claimants, such claims being measured by and co-extensive with the amounts due those trust claimants as of the date of suspension of the bank.*

Claimants of an insolvent national bank, whose uninvested trust funds are secured by assets segregated in the trust

department, as in the instant case, are given what might be termed a statutory preference with respect to the assets thus segregated, but it is maintained that a proper construction of the act will not permit an extension of the protection to cover interest subsequent to the date of suspension in the absence of a specific provision in the statute to that effect. A similar question was discussed in the case of *Greva* v. *Rainey*, 41 Pac. (2d) 328, decided by the Supreme Court of California in 1935. In that case the Pan American Bank of California was in process of liquidation. The applicable portion of the State Banking Act provided for the apportionment of the capital and surplus for each department with the approval of the Superintendent of Banks and a bank having several departments was required to keep the books, deposits, reserves, cash, securities, investments, etc. separate from each of the other departments. All the money and assets belonging to each department were required to be held solely for the re-payment of the depositors and other claimants of such department until all depositors and other claimants of each department had been paid and then the overplus remaining could be applied to any other liabilities of such bank. The question before the court was whether the depositors of the commercial department who had been paid the principal amounts of their claims, were entitled to interest from the date the bank closed to the date of the payment of their claims before any transfer of funds to liquidate the claims of depositors in the savings department. The court in deciding that the creditors of the commercial department were not entitled to interest before the creditors of the savings department were paid in full, said on page 331:

> "The decisions, including those hereinabove cited, are uniform to the effect that in so far as is possible the creditors of an insolvent debtor must be treated on a basis of equality. See, also, White v. Knox, 111 U. S. 784, 4 S. Ct. 686, 28 L. Ed. 603; Thomas v. Western Car Co., 149 U. S. 95, 116, 117, 13 S. Ct. 824, 37 L. Ed. 663. That, indeed, is the premise from which springs

> the rule that interest ordinarily will not be computed nor paid from the date of the suspension of business, or commencement of the receivership or other liquidation procedure. Therefore, there being but one debtor involved, all creditors are entitled to equal consideration except where the statute expressly provides otherwise ,and then only to the extent provided. It follows that the fact that section 27 requires the assets of each department to be held solely for the 'repayment of the depositors' of that department is not to be held to enlarge the rights of such depositors so as to include interest when the act is silent on the matter and otherwise interest would not be recoverable. The reasoning to be applied when the question is one of interest as between creditors is stated in People v. American Loan and Trust Co., supra, viz.: 'Interest should not run in favor of one creditor at the expense of another, while the law, acting for all, is administering the assets.' "

The provisions of 11(k) of the Federal Reserve Act relating to the segregation of assets in the trust department to protect uninvested trust funds (pages 25 and 26 of App. of petitioners' original brief) do not prescribe that those assets secure interest computed on the amount of the uninvested trust funds for any period subsequent to the date of insolvency. Hence, the respondents in this case are in a position very similar to the claimants in the case of *Greva* v. *Rainey, supra,* and *People* v. *American Loan and Trust Company, supra.* They have a preferred right to be paid the amounts due them as of the date of insolvency out of the proceeds of certain of the assets of the bank, but as was said in the case of *People* v. *American Loan and Trust Company,* 172 N. Y. 371, 65 N. E. 200, at page 379:

> "As the statute does not say that preferred claims shall be paid with interest to the date of payment, the courts should not, because the claims of substantially all of the creditors, both preferred and unpreferred, were alike in origin, for they were created by the deposit of money, and preferences in derogation of the common law should not be extended by construction beyond the express command of the statute."

It is the duty of the receiver, when he takes possession of all of the assets of the bank under the applicable statutory provisions to ascertain, in the orderly course of liquidation and administration, what claims are entitled to the protection of the assets segregated in the trust department under the provisions of 11(k) of the Federal Reserve Act. Many of these claims are subject to doubt and other claims not appearing on the trust department books may be subsequently established as entitled to the protection of said securities. Hence, delays in payment of the trust claims are inevitable and indeed, essential to the equitable distribution of the proceeds of the assets of the bank. Therefore, in the instant case, the delay in paying the respondents was in no sense the fault of the debtor corporation or of the unsecured creditors of the bank. There was no contract for the payment of interest on respondents' claim, therefore, interest could be allowed only in the form of damages. Under these circumstances, it would appear to be shockingly inequitable to encroach upon the rights in the assets already vested in all of the creditors by virtue of the operation of law upon the suspension of the bank, for the purpose of paying damages to the secured creditors for the inevitable delays of liquidation and distribution which are suffered alike by the unsecured as well as the secured creditors.

As to the other point discussed in the brief of the Reconstruction Finance Corporation, beginning on page 19, to the effect that the rule contended for by petitioners would be detrimental to national banks, we need only say that such an argument might be pertinent respecting the future legislative policy of the Congress but cannot be considered as a justification for judicial modification of existing laws as interpreted by the courts under applicable rules of construction.

It is respectfully submitted that the decree of the United States Circuit Court of Appeals for the First Circuit in so far as it provides for the payment of interest to the claim-

ants for a period subsequent to the date of insolvency of the Peoples-Ticonic National Bank should be reversed.

F. HAROLD DUBORD,
Attorney for Petitioners.

GEORGE P. BARSE,
TREVOR V. ROBERTS,
JAMES LOUIS ROBERTSON,
Attorneys for the Comptroller of the Currency,
Of Counsel.

APPENDIX.

Section 8 of Regulation F of the Federal Reserve Board as amended October 17, 1930.

(a) *In General.*—Funds received or held in the trust department of a national bank awaiting investment or distribution shall be invested or distributed as soon as practicable and shall not be held uninvested by the bank any longer than is reasonably necessary.

(b) *Deposits in commercial or savings department of trustee bank.*—Funds received or held in the trust department of a national bank awaiting investment or distribution may be deposited in the commercial department or savings department of the bank to the credit of the trust department; provided that the bank first delivers to the trust deparment, as collateral security—

(1) Bonds, notes, or certificates of indebtedness of the United States; or

(2) Other readily marketable securities of the classes in which State trust companies or State banks exercising trust powers are authorized or permitted to invest trust funds under the laws of the State in which such bank is located; or

(3) Other readily marketable securities of the classes defined as "investment securities" pursuant to section 5136 of the Revised Statutes of the United States as amended by the act of February 25, 1927.

The United States bonds or other securities so deposited as collateral shall be owned by the bank and shall at all times be at least equal in market value to the amount of trust funds so deposited in the commercial department.